

Grid for income year

Interest Computation Under the Look-Back Method for Completed Long-Term Contracts

For contracts completed or adjusted during the taxable or income year beginning: month \_\_\_ day \_\_\_ year \_\_\_, and ending month \_\_\_ day \_\_\_ year \_\_\_. Name(s) as shown on return

Form fields for Social security or California corporation number, Address, Apt. no., PMB no., FEIN, City, town, or post office, State, ZIP Code

Check applicable box

- Individual, Estate, Trust, C corporation, S corporation, Limited liability company (LLC), Exempt organization, Other

If you were an owner of an interest in a pass-through entity (S corporation, estate or trust, partnership or LLC taxed as a partnership) that holds one or more long-term contracts to which this interest computation relates, enter the name and identification number of the entity.

Name of entity, Identification number

Check this box if more than 3 prior years are involved. Attach additional form(s) FTB 3834 as needed. See General Information J, Miscellaneous.

Part I Regular Method

Table with 4 columns: (a) Year ended, (b) Year ended, (c) Year ended, (d) Total. Rows 1-10 detailing taxable income, adjustments, and interest due.



# Instructions for Form FTB 3834

## Interest Computation Under the Look-Back Method for Completed Long-Term Contracts

References in these instructions are to the Internal Revenue Code (IRC) as of **January 1, 1998**, and to the California Revenue and Taxation Code (R&TC).

### General Information

#### What's New

##### Preparer Tax Identification Number (PTIN)

Tax preparers now have the option of using a unique identification number (PTIN) instead of their social security number when signing tax returns.

#### Conformity

In general, California tax law conforms to the Internal Revenue Code (IRC) as of January 1, 1998. However, there are continuing differences between California and federal tax law. California has not conformed to most of the changes made to the IRC by the federal Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (Public Law 105-206) and has not conformed to any of the changes made by the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277). As a result, certain federal changes applicable to taxable or income years ending after August 5, 1997, will only be applicable for California income or franchise tax purposes to taxable or income years beginning on or after January 1, 1998.

California conforms to federal law for the following provisions:

- For taxable or income years beginning on or after January 1, 1998, you may elect to have the look-back method not apply in certain de minimis cases. See General Information C, Exceptions, for more information.
- For contracts completed in taxable or income years ending on or after January 1, 1998, new rules apply to determine the period for which the rate applies. See the instructions for Part I, line 7 and line 8 for more information.

#### A Purpose

In the year a long-term contract is completed, the look-back method described in IRC Section 460(b)(2) requires the taxpayer to "look back" to each of the previous years during which the contract work was in progress. The taxpayer must compute interest in such years on the difference between the tax that was actually paid and the tax that would have been paid if the taxpayer had known the actual contract price and costs that would finally result.

Use form FTB 3834 to figure the interest due or to be refunded under the look-back method (IRC Section 460(b)(2)) on certain long-term contracts entered into after February 28, 1986, that are accounted for under either the percentage of completion method or the percentage of completion-capitalized cost method.

#### B Who Must File

File form FTB 3834 for each taxable or income year in which a long-term contract, as described above, is completed. You also must file form FTB 3834 for any taxable or income year in

which the contract price or contract costs are adjusted for one or more long-term contracts from a prior year.

See the instructions for federal Form 8697, Interest Computation Under the Look-Back Method for Completed Long-Term Contracts, for more information about filing requirements such as how to determine whether the look-back interest computation is required at the entity or ownership level in the case of a pass-through entity (S corporation, estate or trust, partnership, or LLC taxed as a partnership).

##### Private Mailbox (PMB) Numbers

If you lease a mailbox from a private business rather than from the United States Postal Service, enter the box number in the special field labeled "PMB no."

#### C Exceptions

The look-back method does not apply to regular taxable income from:

- Any home construction contract (as defined in IRC Section 460(e)(6)(A));
- Any construction contract entered into:
  - (a) that you estimate the contract will be completed within two years from the contract commencement date, and
  - (b) where average annual gross receipts for the three taxable or income years before the taxable or income year the contract is entered into do not exceed \$10 million (see IRC Section 460(e)); or
- Any contract completed within two years from the contract commencement date, if the gross price of the contract (as of contract completion) does not exceed the smaller of:
  - (a) \$1 million, or
  - (b) 1% of average annual gross receipts for the three tax years before the tax year of contract completion (see IRC Section 460(b)(3)(B)).

**De Minimis Exception.** You may elect not to apply the look-back method in certain de minimis cases for contracts completed in taxable or income years beginning on or after January 1, 1998. The look-back method does not apply in the following cases if the election is made:

1. In the completion year if, for each prior contract year, the cumulative taxable income (or loss) actually reported under the contract is within 10% of the cumulative look-back income (or loss). Cumulative income (or loss) is the amount of taxable income (or loss) that you would have reported if you had used actual contract price and costs instead of estimated contract price and costs.
2. In a post-completion year if, as of the close of the post-completion year, the cumulative taxable income (or loss) under the contract is within 10% of the cumulative look-back income (or loss) under the contract as of the close of the most recent year in which the look-back method was applied to the contract

(or would have been applied if the election had not been made).

For purposes of item 2, discounting under IRC Section 460(b)(2) does not apply.

To make the election, attach a statement to your timely filed tax return (determined with extensions) for the first taxable or income year of the election. Write at the top of the statement "NOTIFICATION OF ELECTION UNDER IRC SECTION 460(b)(6)." Include on the statement your name, identification number, and the effective date of the election. Also identify the trades or businesses that involve long-term contracts. Once made, the election applies to all contracts completed during the election year and all later taxable or income years and may not be revoked except with the written consent of the Franchise Tax Board (FTB).

**Contract commencement date:** The first date on which any costs (other than bidding expenses or expenses incurred in connection with negotiating the contract) allocable to the contract are incurred. For more information, see IRC Section 460(g).

#### D When to File

File form FTB 3834 at the time you are required to file your California tax return (including extensions) for your taxable or income year in which one or more long-term contracts are completed (or at any other time required by IRC Section 460 or the regulations thereunder).

- Individuals, estates or trusts, partnerships, and LLCs must sign Side 2 and file form FTB 3834 as a separate return (do **not** attach it to Form 540, 540NR, 541, 565, or 568).
- Corporations, S corporations, and exempt organizations must enter the interest due or to be refunded on the appropriate line of their return and attach form FTB 3834 to their Form 100, 100S, or 109. See instructions for Part I, line 9 and line 10. Corporations, S corporations, and exempt organizations are not required to sign form FTB 3834.

If you were an owner of an interest in a pass-through entity that has completed one or more long-term contracts, file form FTB 3834 for your taxable or income year that ends with or includes the end of the entity's taxable or income year in which the contract was completed.

#### E Period Covered

Fill in the taxable or income year line at the top of the form to show the year the contract was completed or adjusted.

If you were an owner of an interest in a pass-through entity that has completed one or more long-term contracts, enter your taxable or income year ending with or including the end of the entity's taxable or income year in which the contract was completed.

## F Alternative Minimum Taxable Income (AMTI)

If you apply the percentage of completion method to income from a long-term contract only for purposes of determining AMTI, you must apply the look-back method to AMTI in the year of contract completion. This rule applies whether or not you are liable for alternative minimum tax (AMT) for the filing year or for any prior taxable or income year.

Interest is computed under the look-back method to the extent your total tax liability (including the AMT liability) would have differed if the percentage of completion method had been applied using actual, rather than estimated, contract price and contract costs.

## G Amended Form FTB 3834

Individuals, estates or trusts, partnerships, and LLCs must file an amended form FTB 3834 only if the amount shown on Part I, line 6 or Part II, line 7 for any prior year changes as a result of an error, an income tax examination, or the filing of an amended income tax return. Follow the corresponding filing instructions for Part I, line 9 and line 10.

## H Simplified Marginal Impact Method

Treasury Regulation (Treas. Reg.) Section 1.460-6(d) established the simplified marginal impact method for figuring look-back interest. Pass-through entities that are not closely held **must** use this simplified method. All other taxpayers may elect to use this method for domestic contracts.

A pass-through entity is considered closely held if, at any time during any taxable or income year for which there is income under the contract, 50% or more (by value) of the beneficial interests in the entity are held (directly or indirectly) by or for five or fewer persons.

Under the simplified method, hypothetical underpayments or overpayments of tax in prior years are figured using an assumed marginal tax rate which is generally the highest statutory rate of tax in effect for each prior year under R&TC Sections 17041 and 23151. This method eliminates the need to refigure your tax liability based on actual contract price and actual contract costs each time the look-back method is applied.

If you elect the simplified method, it must be used in the election year and all later years, unless the FTB consents to a revocation of the election. Use Part II to figure the simplified marginal impact method.

## I S Corporations

S corporations using Part II, the Simplified Marginal Impact Method, must complete form FTB 3834 for each completed long-term contract to compute the interest due from or to be refunded to the S corporation as a result of the franchise tax imposed on S corporations. An S corporation cannot file form FTB 3834 on behalf of its shareholders. Shareholders of the S corporation each must make separate

elections and file form FTB 3834 using the applicable individual rates.

## J Miscellaneous

If more than three prior years are involved, check the box above Part I, Side 1 of form FTB 3834. Attach additional form(s) FTB 3834 as needed. Enter your name, identifying number, and taxable or income year. Complete Part I, line 1 through line 8; or Part II, line 1 through line 9; but do not enter totals in column (d). Enter totals **only** in column (d) of the form FTB 3834 that you sign.

Follow the instructions in federal Form 8697 when applying the look-back method under special situations, such as:

- Change orders;
- Treatment of amounts properly taken into account after contract completion;
- The delayed reapplication method; and
- The 10% method.

## Specific Line Instructions

### Part I — Regular Method

Use Part I only if you are not electing, do not have an election in effect, or are not required to use the simplified marginal impact method as described in General Information H, Simplified Marginal Impact Method.

**Columns (a), (b), and (c)** – At the top of each column, enter the ending month and year for each prior taxable or income year in which you were required to report income from the completed long-term contract(s) and for any other year affected.

**Line 2** – In each column, show a net increase to income as a positive amount and a net decrease to income as a negative amount. For apportioning taxpayers, the net increase or net decrease to income is after apportionment. For more information, see Title 18, California Code of Regulations Section 25137-2.

In figuring the net adjustment to enter in each column on line 2, be sure to take into account any other income and expense adjustments that may result from the increase (or decrease) to income from long-term contracts. For example, in the case of an individual, a change to adjusted gross income may affect investment expenses and medical expenses under R&TC Section 17201; in the case of a corporation, the apportionment percentage may be affected by a change in the gross receipts included in the sales factor.

Attach separate schedules for regular taxable income or net income and AMTI that include:

- Identification of each completed long-term contract by contract number, job name, or any other reasonable method used in your records to identify each contract;
- The amount of income previously reported for each contract based on estimated contract price and costs for each prior year;
- The amount of income for each contract allocable to each prior year based on actual contract price and costs;
- The net adjustment to income from long-term contracts for each prior year; and

- Any other adjustments that result from the change to income from long-term contracts.

An owner of an interest in a pass-through entity is not required to provide the detail listed in the first three items above with respect to prior years. The entity should provide the line 2 amounts on a Schedule K-1 (100S, 541, 565, or 568) or on a separate statement for its taxable or income year in which the contracts are completed or adjusted.

If you are reporting line 2 amounts from more than one Schedule K-1 (100S, 541, 565, or 568) or similar statement, you must attach a schedule detailing by entity the net change to income from long-term contracts.

### Net Adjustment

California law requires you to make an adjustment to income upon completion of a contract to correct any underreporting or overreporting of income resulting from differences between state and federal law for the taxable or income year in which the contract began. This adjustment may be necessary:

For a contract entered into after:	During a taxable or income year beginning before:
February 28, 1986	January 1, 1987
October 13, 1987	January 1, 1990
June 20, 1988	January 1, 1990
July 10, 1989	January 1, 1990

For purposes of the look-back method, include this adjustment amount in the amount entered on line 2 for the taxable or income year from which the adjustment arose. Attach a schedule showing your computation.

The schedule must be prepared in columns for the affected years so that the net adjustment shown in each column on the attached schedule agrees with the amounts shown on line 2.

**Line 4 and Line 5** – The tax to be entered on line 4 and line 5 must be reduced by allowable credits (other than refundable credits). Include any taxes (such as AMT) required to be taken into account in the computation of your tax liability determined as of the latest of the following:

- The original due date;
- The date of an amended or adjusted return; or
- The last previous application of the look-back method.

See Treas. Reg. Section 1.460-6(c)(3)(iii) for exceptions and further explanation.

**Note:** Corporations cannot reduce their tax below the minimum franchise tax.

**Line 7 and Line 8** – For an increase (or decrease) in tax for each prior year, interest due or to be refunded must be compounded on a daily basis from the due date (not including extensions) of the return for the prior year until the earlier of the:

- Due date (not including extensions) of the return for the contract completion year; or
- Date the return for the contract completion year is filed and any tax due for that year has been fully paid.

**Contracts Completed in Taxable or Income Years Ending Before January 1, 1999**

For contracts completed in taxable or income years ending before January 1, 1999, the interest rates to be compounded daily are:

Period	Rate
July 1, 1989, through December 31, 1989	12%
January 1, 1990, through June 30, 1991	11%
July 1, 1991 through June 30, 1992	10%
July 1, 1992 through December 31, 1992	9%
January 1, 1993, through June 30, 1993	8%
July 1, 1993 through December 31, 1994	7%
January 1, 1995 through June 30, 1995	8%
July 1, 1995 through December 31, 1998	9%
January 1, 1999 through June 30, 1999	8%
July 1, 1999 to December 31, 1999	7%
January 1, 2000 to June 30, 2000	8%

**Contracts Completed in Taxable or Income Years Beginning On or After January 1, 1999**

For contracts completed in taxable or income years beginning on or after January 1, 1999, the interest rate is determined for each **interest accrual period**. The interest accrual period starts on the day after the return due date (not including extensions) for each prior taxable or income year and ends on the return due date for the following taxable or income year. Using the chart above, the interest rate in effect for the entire interest accrual period is the rate for the period in which the interest accrual period begins.

**Line 9 and Line 10** – Individuals, estates or trusts, partnerships, and LLCs must sign Side 2 and file form FTB 3834 as a separate return (do **not** attach it to Form 540, 540NR, 541, 565, or 568). Mail the form in an envelope separate from that of your California tax return.

Corporations (other than S corporations) may deduct this amount as an interest expense for the income year in which it is paid or incurred. This interest is not deductible for individuals and other noncorporate taxpayers.

- If you have an amount to be refunded to you (line 9), mail form FTB 3834 to:

FRANCHISE TAX BOARD  
PO BOX 942840  
SACRAMENTO CA 94240-0000

- If you have an amount due (line 10), prepare a check or money order payable to "Franchise Tax Board" for the full amount. Write your social security number or California corporation number, the taxable or income year, and "FTB 3834" on the check or money order. Attach it to form FTB 3834 and mail to:

FRANCHISE TAX BOARD  
PO BOX 942867  
SACRAMENTO CA 94267-0001

Corporations, S corporations, and exempt organizations with unrelated business income must attach form FTB 3834 to their California return and enter the amount due or the amount to be refunded on the appropriate schedule of their tax return as follows:

- Corporations must enter an amount due or a refund due on Form 100, Schedule J;
- S corporations must enter an amount due or a refund due on Form 100S, Schedule J; and

- Exempt corporations or other organizations with unrelated business income must enter an amount due or a refund due on Form 109, Schedule K.

**Note:** Corporations, S corporations and exempt organizations are not required to sign form FTB 3834.

**Part II — Simplified Marginal Impact Method**

Part II is used only by pass-through entities required to apply the look-back method at the entity level and taxpayers electing (or with an election in effect) to use the simplified marginal impact method. See General Information H, Simplified Marginal Impact Method.

To elect the simplified marginal impact method, attach a statement to form FTB 3834 for the first tax year of the election. The statement must indicate that you are making an election under Treas. Reg. Section 1.460-6(d) to use the simplified marginal impact method. Once made, the election applies to all applications of the look-back method in the year of the election and all later years, unless the FTB consents to a revocation of the election.

**Columns (a), (b), and (c)** – Enter at the top of each column the ending month and year for each prior taxable or income year in which you were required to report income from the completed long-term contract.

**Line 1** – In each column, show a net increase to income as a positive amount and a net decrease to income as a negative amount. For apportioning taxpayers, the net increase or net decrease to income is after apportionment. For more information, see Title 18, California Code of Regulations Section 25137-2.

Attach separate schedules for regular taxable income and AMTI that include:

- Identification of each completed long-term contract by contract number, job name, or any other reasonable method used in your records to identify each contract;
- The amount of income previously reported for each contract based on estimated contract price and costs for each prior year;
- The amount of income for each contract allocable to each prior year based on actual contract price and costs;
- The net adjustment to income from long-term contracts for each prior year; and
- Any other adjustments that result in a change to income due to long-term contracts.

An owner of an interest in a pass-through entity is not required to provide the detail listed in the first three items above with respect to prior years. The entity should provide the line 1 amounts on a Schedule K-1 (100S, 541, 565, or 568) or on a separate statement for its taxable or income year in which the contracts are completed or adjusted.

If you are reporting line 1 amounts from more than one Schedule K-1 (100S, 541, 565, or 568) or similar statement, you must attach a schedule detailing by entity, the net change to income from long-term contracts.

**Note:** See Specific Line Instructions, **Net Adjustment**, on page 2.

**Line 2** – Multiply the amount on line 1 by the applicable regular tax rate for each prior year shown in column (a), (b), or (c). The applicable regular tax rate is as follows:

Entity	Regular rate
<b>(a) Individuals and pass-through entities in which, at all times during the year, more than 50% of the interests in the entity are held by individuals directly or through other pass-through entities:</b>	
Tax years beginning before 1987	11%
Tax years beginning after 1986 and before 1991	9.3%
Tax years beginning after 1990 and before 1996	11%
Tax years beginning after 1995	9.3%
<b>(b) S corporations:</b>	
Income years beginning after 1986 and before 1994	2.5%
Income years beginning after 1993	1.5%
<b>(c) Corporations and pass-through entities not included in (a) or (b) above:</b>	
Income years ending before 1987	9.6%
Income years ending after 1986 and beginning before 1997	9.3%
Income years ending after 1996	8.84%

**Note:** Corporations cannot reduce their tax below the minimum franchise tax.

**Line 3** – See the instructions for Part II, line 1, and complete line 3 in the same manner, using only income and deductions allowed for AMT purposes.

**Line 4** – Multiply the amount on line 3 by the applicable AMT rate as follows:

Entity	AMT rate
<b>(a) Individuals and pass-through entities in which, at all times during the year, more than 50% of the interests in the entity are held by individuals directly or through other pass-through entities:</b>	
Tax years beginning after 1986 and before 1991	7%
Tax years beginning after 1990 and before 1997	8.5%
Tax years beginning after 1996	7%
<b>(b) Corporations and pass-through entities not included in (a) above:</b>	
Income years ending after 1986 and beginning before 1997	7%
Income years ending after 1996	6.65%

**Line 5** – If both line 2 and line 4 are negative, enter whichever amount is larger. Treat both numbers as positive when making this comparison, but enter the amount as a negative number. If the amount on one line is negative, but the amount on the other line is positive, enter the positive amount on line 5.